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No. 87-600

In The
Supreme Court of the United States
October Term, 1987

—o—

THE VARIABLE ANNUITY LIFE INSURANCE COMPANY, ET AL., PETITIONERS

v.

BEVERLY J. OTTO, INDIVIDUALLY, AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, RESPONDENT

—o—

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

—o—

MOTION FOR LEAVE TO FILE BRIEF FOR THE NATIONAL ASSOCIATION OF LIFE COMPANIES AS AMICUS CURIAE AND BRIEF AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

—o—

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MOTION FOR LEAVE TO FILE BRIEF FOR THE NATIONAL ASSOCIATION OF LIFE COMPANIES AS AMICUS CURIAE

Pursuant to Rule 36 of the Rules of this Court, the National Association of Life Companies ("NALC") requests leave to file the accompanying brief as *amicus curiae* in support of petitioners. Counsel for petitioners

has consented to the filing of this *amicus curiae* brief, but counsel for respondent has declined consent.

NALC is a nationwide trade association with a membership of 634 small and medium-sized life insurance companies. Small and medium-sized companies constitute 90% of the total number of life insurance companies in the country. NALC's member companies have in force more than $480 billion in insurance policies involving 68 million policyholders. These companies have in excess of $40 billion in aggregate assets and $13 billion in premium income.

A significant number of NALC's members issue excess interest fixed annuities like that of petitioner The Variable Annuity Life Insurance Company ("VALIC") that the court of appeals held to be a "security" for purposes of the federal securities laws. That decision is inconsistent with the common understanding in the industry that these policies are "insurance" and therefore not subject to the securities laws. Moreover, compliance with the various requirements of federal law would impose an especially heavy burden on small and medium-sized companies such as those that belong to NALC.

NALC believes that this *amicus curiae* brief will assist the Court in understanding the substantial public importance and practical consequences of the question presented in VALIC's petition. NALC has participated as *amicus curiae* in other federal cases to represent the interests of its members.

For the foregoing reasons, the motion of NALC for leave to file the accompanying brief as *amicus curiae* in support of petitioners should be granted.

Respectfully submitted.

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BRIEF FOR THE NATIONAL ASSOCIATION OF LIFE COMPANIES AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICUS CURIAE

The National Association of Life Companies ("NALC") is a nationwide trade association of small and medium-sized insurance companies. Its interest in the question presented in this case is fully described in the

accompanying motion for leave to file this brief as *amicus curiae* in support of petitioners.

ARGUMENT

A. Excess Interest Fixed Annuities Are "Insurance" And Not "Securities."

As The Variable Annuity Life Insurance Company ("VALIC") demonstrates in its petition for certiorari, the excess interest fixed annuity at issue in this case has all of the features of the traditional fixed annuity that Congress intended to exclude from the federal securities laws: it contains a complete guarantee of all principal; it provides a guaranteed rate of interest for the life of the policy; its funds are included in the insurer's general assets and are invested in long-term debt-type instruments; it is sold on the usual insurance basis of stability and security and is designed to provide a long-term accumulation of retirement funds through compound interest; and it is extensively regulated by state insurance commissioners. Thus, the policyholder is guaranteed principal and a fixed rate of return regardless of the investment experience of the insurer or general economic conditions, and the company correspondingly bears a substantial investment risk.[1]

The court of appeals did not dispute these characteristics. Instead, it relied on the fact that VALIC's annuity

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1 The importance of these protections for policyholders and the role of fixed annuities in guarding against investment risks have been graphically illustrated by recent stock market events. See, e.g., Wall St. J., Oct. 22, 1987, at 37, col. 4.

also contained a discretionary excess interest provision that did not meet one of the requirements for "safe harbor" treatment under the Security and Exchange Commission's recently promulgated Rule 151.[2] But that does not change the essential nature of the instrument. While the possibility of a higher interest rate (at the discretion of the insurer) marginally shifts a part of the investment risk to the policyholder, the insurer retains a significant —indeed, the predominant—share of the risk. The cornerstone of the policy—the guarantee of principal and a specified return based on conservative long-term investment of the insurer's general assets pursuant to state insurance laws—establishes that the excess interest fixed annuity is an insurance product and not a security. Indeed, a number of recognized insurance products, such as participating dividend life insurance policies and universal life policies, resemble the excess interest provision because the return to the policyholder depends to some extent on the profits earned by the insurer.

For these reasons, the insurance industry has widely understood that excess interest fixed annuities constitute "insurance" exclusively regulated by the states and not "securities" subject to the federal securities laws. In fact, the decision below is the first to apply the securities laws to a fixed annuity. As we now show, that erroneous decision, if not reversed by this Court, will have substantial adverse consequences for the insurance industry.

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2 For the reasons stated in VALIC's petition, the court of appeals' application of Rule 151's "safe harbor" represents a serious misconstruction of an important provision of federal law that warrants this Court's review.

B. The Court Of Appeals' Erroneous Decision Will Substantially Affect The Insurance Industry.

If, contrary to the insurance industry's understanding, excess interest fixed annuities like VALIC's are securities for purposes of the federal securities laws, significant changes will be required in the way in which issuers of these policies conduct their business. Such changes will be disruptive and costly, especially for small and medium-sized insurance companies like NALC's members. At a minimum, the necessary changes will drive up the costs of these policies for consumers. In addition, the increased burden and expense may lead some issuers to withdraw from this market, thereby both restricting the availability of these policies to the public and reducing the diversity of policies that continue to be offered.

Moreover, the effects of the decision below will be immediate and widespread even though only one court of appeals has held excess interest fixed annuities to be securities. Companies that sell these annuities within the Seventh Circuit—and most fixed annuity issuers do—will at once have to comply with the court of appeals' decision by meeting the numerous requirements of the federal securities laws. Because, as a practical matter, compliance with many of these requirements cannot be confined to a particular geographical area, the ruling below will effectively have a nationwide impact.

NALC's concern about the expense and disruption that will result from the court of appeals' decision can be illustrated by two examples. If excess interest fixed annuities are securities, they are subject to the registration

and prospectus requirements in Sections 6-10 of the Securities Act of 1933, 15 U.S.C. §§ 77f-77j. By the same token, an issuer of securities registered under the 1933 Act also is required to file a number of public reports under Section 15(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78*o*(d). Currently, however, excess interest fixed annuities do not have to be registered as securities and many issuers of these annuities are not otherwise covered by public reporting obligations. The novel application of these provisions to excess interest fixed annuities, as the court of appeals' decision would require, would impose substantial additional costs in the sale of such annuities.

In addition, if these fixed annuities are securities, the companies that issue them and the agents that sell them must register under the "broker/dealer" provisions of the federal securities laws. In contrast, under present law, insurance companies and their agents are required to be licensed only by state insurance commissioners pursuant to the standards established in each state. To meet the many conditions prescribed by federal law—including strict minimum capital criteria for the issuing company, stringent securities training and competency requirements for sales agents, and extensive recordkeeping obligations —would necessitate a fundamental change in business operations and would intrude upon the exclusive authority of state insurance regulators.

Compliance with the federal securities laws will be particularly onerous for small and medium-sized insurance companies. Because the costs of compliance generally are not a function of the volume of securities sold, smaller

companies issuing relatively fewer policies will bear a disproportionate burden in relation to the size of their annuity business. Beyond that, smaller companies typically are less familiar with the requirements of the federal securities laws and do not have large staffs of in-house counsel, thereby further increasing the practical burden of compliance.

Of course, if the federal securities laws dictate that excess interest fixed annuities be treated as securities, the costs of compliance will have to be borne by large and small companies alike. But until now, that has not been the ~~accepted~~ understanding of the scope of federal law. The insurance industry should not be forced to make major changes in its method of doing business unless this Court determines that such a drastic result is clearly required.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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